State of Michigan

Management Internal Control Evaluation

Rick Lowe, State Budget Office
Karen Spak, Community Health
Mike Kelterborn, State Police
Sherri Forbes, State Police

Spring 2001 SAAABA seminar
March 19, 2001

Perspectives of:

- **Central Oversight**
  - ✦ State Budget Office (SBO)

- **Agency Implementation**
  - ✦ Community Health
  - ✦ State Police

State Budget Office

COSO Based Evaluations
"A Statewide Perspective"

Rick Lowe

SBO Overview

- State Law (DMB Act)
- Development of the General Framework and System of Reporting
- Key Principles of the COSO Based Guidance
- Ongoing Efforts to Improve the Process
- Signs of Progress

State Law (DMB Act)

- DMB has a primary responsibility to establish a comprehensive system of internal control to manage financial affairs of the State.

- DMB, in consultation with the Auditor General, shall develop a general framework and system of reporting …

STATE OF MICHIGAN

EVALUATION OF INTERNAL CONTROLS

A GENERAL FRAMEWORK AND SYSTEM OF REPORTING

ISSUED BY THE
OFFICE OF FINANCIAL MANAGEMENT

1999 REVISION

www.state.mi.us/dmb/ofm

Definition of Internal Control

A process, effected by the director, management, and support staff of each State department, designed to provide reasonable assurance towards accomplishment of each principal department's mission, objectives, and goals.

Development of the General Framework and System of Reporting

- Findings of a Multi-Agency Workgroup

- COSO Pyramid

- Evaluation Tools

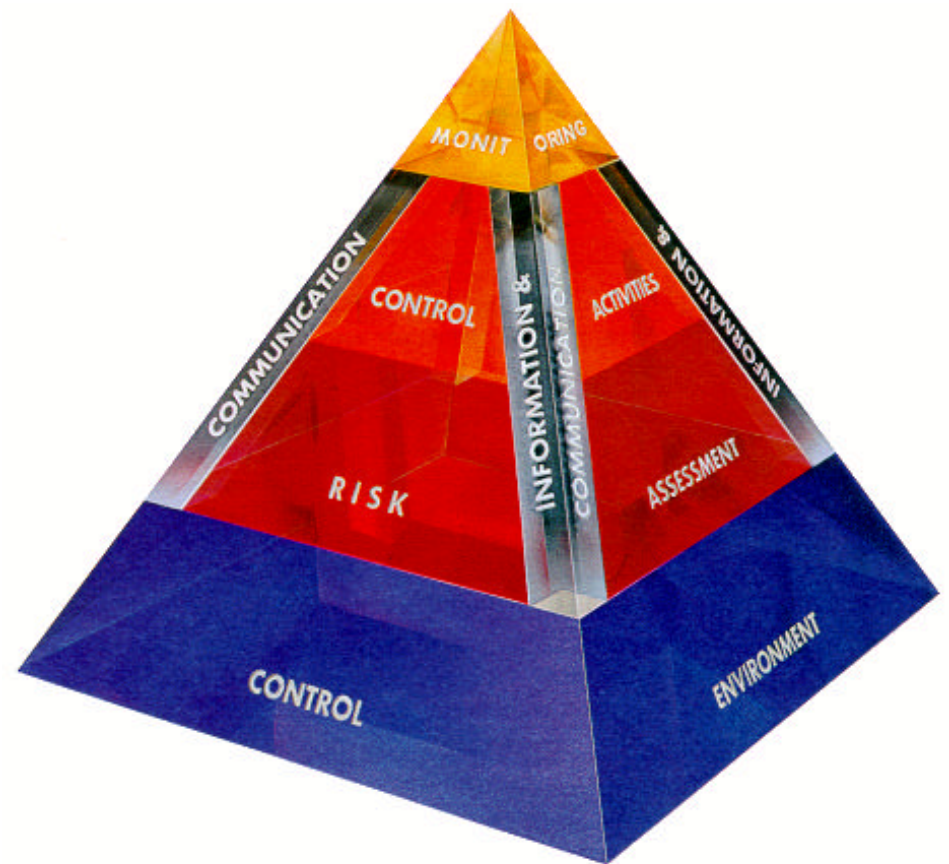- Reporting Evaluation Conclusions

COSO Pyramid

- **Objectives**
  - Operations
  - Financial Reporting
  - Compliance

- **Components**
  - Control Environment
  - Risk Assessment
  - Control Activities
  - Information and Communication
  - Monitoring

Office of Financial Management
State Budget Office

WELCOME   WHAT'S NEW   SITE SEARCH   HOME

STATE of MICHIGAN   DEPARTMENT of MANAGEMENT and BUDGET

Office Responsibilities

Organization

Financial Reporting

Policies & Procedures

User Guides

Letters/Directives

Contact Us

FAQ

What's New

Related Links

State Phone Directory

State Email Directory

Evaluation Tool Sets

NOTE: Users wishing to download and customize the Word95/6.0 files can do so in one of the following ways.
PC Users: press the right mouse button on the link and select "Save Target As..."
Mac Users: press and hold mouse button on the link and select "Save Target As..."

Background and Instructions for use of Evaluation Worksheets

Control Environment - Evaluation Worksheet   PDF   Word 95/6.0

Information & Communication - Evaluation Worksheet   PDF   Word 95/6.0

Risks, Control Activities, and Monitoring   PDF   Word 95/6.0
     (Non-Financial Activities) -Evaluation Worksheet

Risks, Control Activities, and Monitoring Associated with   PDF   Word 95/6.0
     Financial Management Activities
     - Evaluation Worksheet

Internal Controls over Automated Information Systems -   PDF   Word 95/6.0
     Evaluation Worksheet

CobiT - Control Objectives   PDF   Word 95/6.0

Soft Control Factors
("People Controls")

- Assignment of Authority and Responsibility

- Commitment to Competence

- HR Policies and Procedures

- Integrity and Ethical Values

- Management's philosophy and operating style

- Organization Structure

- Oversight Groups

- Internal and External Communications

ICS Evaluation Worksheet
(Hard Controls)

State of Michigan
Evaluation of the Internal Control Structure (ICS)
In Effect During the Two-year Period Ended September 30, 2000

- Worksheet for Evaluating the *Risks, Control Activities, and the Monitoring* Components of the ICS -

Description of Departmental Activity:
Overall Objective:

Activity Level Objectives	Risk Factors Associated with the Activity Level Objective	Significance	Likelihood	Actions/Control Activities Intended to Address Risk Factors	Monitoring (e.g., tests of controls, checklists, tools, reports, etc.)	Conclusion (Sufficiency/Effectiveness of Existing Internal Controls)

Evaluation Conclusions
(15 Cell Grid)

	Efficiency and Effectiveness of Operations	Reliability of Financial Reporting	Compliance with Applicable Laws And Regulations	Overall Conclusion
People Controls (Control Environment , Information & Communication)	🟨	🟩	🟨	🟨
Process Oriented ORCA (Risk Assessment, Control Activities, Monitoring)	🟩	🟩	🟩	🟩
Overall Conclusions	🟩	🟩	🟩	🟩

Overall conclusions reached via analysis and discussion by executive leadership team.

Shade	Meaning	Color
🟩	Control is sound	Green
🟨	Some control issues	Yellow
🟥	Major control issues	Red

Exh. 1

Evaluation Conclusions (Report to Governor)

To: Michigan Governor

"Except for the weaknesses noted below, the Department of XXXXX has reasonable assurance that measures are being used to:

- ◆ **Develop reliable financial reports.**

- ◆ **Promote effective and efficient operations, including the safeguarding of State assets.**

- ◆ **Encourage compliance with applicable laws, rules, and regulations (including prescribed managerial policies).**

…with respect to the Department of XXXXX's mission and core business objectives."

Signed: Department Director

Corrective Action Plan for Material Weakness attached.
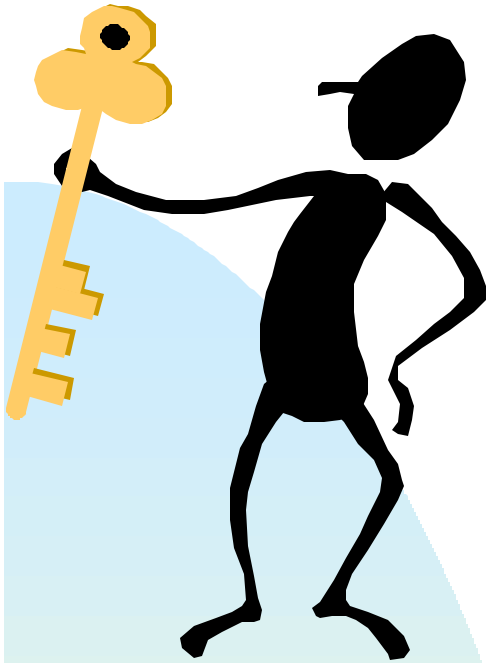
Key Principles of the COSO Based Guidance

- Evaluation strategy: Mission driven

- Focus on core business processes

- Comprehensive documentation

- Risk assessment is ongoing, evaluation (i.e., monitoring) as needed.

- Management Responsibility (effective and proactive management technique)

Ongoing Efforts to Improve the Process

- Issuance of General Framework (December 1999)

- Management Training

- Contract with Jefferson Wells: Agency Assistance

- OFM Best Practices Research

- Web User Forum

STATE OF MICHIGAN

EVALUATION OF
INTERNAL CONTROLS

A GENERAL FRAMEWORK
AND SYSTEM OF REPORTING

ISSUED BY THE
OFFICE OF FINANCIAL MANAGEMENT

1999 REVISION

www.state.mi.us/dmb/ofm

Internal Control Training

- Kickoff Meeting with Senior Leadership (March 2000)

- COSO Implementation (World-Class Training / OFM, Jefferson Wells, Dr. James Roth) (June 2000)

- Control Self Assessment: "COSO-Facilitate That!" (Local IIA - September 2000)

- Jefferson Wells: "Know Your Risks" (Fall 2000)

ICE 2000
Jefferson Wells Contract

Nature of Services Rendered	Number of State Departments
• Review departmental evaluation strategy	9
• Review employee survey tools ("people controls")	9
• Administer confidential employee survey	9 + 3 (HSI)
• Management training: Conducting Risk Assessments	8 (up to 35 presentations to various groups)
• General Consultation	10
• Facilitated control self assessment	3

Note: 5 departments chose not to use these services

Web User Forum

Internal Controls User Forum

Internal Controls - Evaluation Practices
preferences | faq | search

Click Here To View Today's Active Topics (all public forums)

You last visited: 03-16-2001 09:31 AM

Forum	Topics	Posts	Last Post
Internal Evaluation Tools			
Training Questions about upcoming taining; information about good COSO training you attended; suggestions for additional training; etc.	3	4	01-31-2001 09:21 AM
Segmenting your Department You could segment your department into organizational components based upon a business unit, program, activity, and/or process. Segmenting the department into manageable activities is a critical aspect of carrying out a department-wide evaluation in an efficient and effective manner.	1	2	12-11-2000 02:29 PM
Leadership support Support from those individuals resposibile for setting and/or achieving the organization's objectives. Senior management is responsible for ensuring that the process of evaluating, improving, and reporting on internal control is carried out.	1	1	11-17-2000 11:16 AM
Evaluation Tools Evaluation tools should be based on objectives and risks (associated with the department) and allow for consideration of various control activities in place. The most effective tool facilitates the thought process for conducting the evaluation, is automated, and allows for efficient accumulation of data and customization to meet the evaluator's unique needs. Tools are presented on OFM's homepage to illustrate one technique among many, that may be used in whole or in part in an evaluation, or not at all. Tools should be tailored to suit the entity's individual needs.	1	2	12-11-2000 12:15 PM
Soft Controls Soft controls refer to the attitude and actions of management regarding the significance of control within the organization. It includes ethics, commitment to competence, and management operating style. Control environment provides the descipline and structure for achievement of primary objectives of the system of internal control.	2	3	01-30-2001 03:45 PM

Signs of Progress

- Improved Agency Planning
- Standardized Documentation (used by management, IA and OAG)
- Management Ownership
- Quality Initiatives (crosswalk)
- Civil Service: "Competency Based Employee Ratings"

COSO vs. Baldridge

Comparison Item / Criteria	Baldrige	COSO
Purpose	 − To help improve organizational performance practices and capabilities. − To facilitate communication and sharing of best practices information among U. S. organizations of all types − To serve as a working tool for understanding and managing performance and guiding planning and training	**COSO Report (Internal Control – Integrated Framework):** Establishes a common language to facilitate: − Understanding − Communication − Control assessment against a standard − Strengthening of control systems − Future research of best practices **Internal Controls:** Internal controls help management to: − Accomplishing profitability goals and achievement of mission − Deal effectively with changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth − Minimize surprises along the way
Goals	The criteria is designed to help organizations enhance their performance through a dual focus on results and oriented goals aimed at: − Delivering ever-improving value to customers, resulting in market place success, and − Improving overall organizational effectiveness and capabilities	Internal controls are designed to provide management with reasonable assurance regarding the achievement of objectives in the following categories: − Effectiveness and efficiency of operations − Reliability of financial reporting − Compliance with applicable laws and regulations (e.g., mgmt. directives)
Core Values and Concepts	− Visionary Leadership − Customer Driven − Organizational and Personal Learning − Valuing Employees and Partners − Agility − Managing for Innovation − Management by Fact − Public Responsibility and Citizenship − Focus on Results and Creating Value − Systems Perspective	Fundamental concepts of Internal Control: − Is a process − Is effected by people − Provides only reasonable assurance − Is geared toward achievement of objectives in one or more separate but overlapping categories Internal Control Components: − Control Environment − Risk Assessment − Control Activities − Information and Communication − Monitoring
Criteria		
Leadership	Examines how an organization's senior leaders address values and performance expectations, as well as a focus on customers and other stakeholders, empowerment, innovation, learning, and organizational directions. Also examined is how an organization addresses its responsibilities to the	Closely aligned with the *Control Environment* component. Senior management is responsible for maintaining a system of internal control. Management sets the tone with regards to the organization's: − Integrity and ethical values − Incentives and Temptations

Exh. 2

Competency Based Employee Ratings

Sponsor: Civil Service Commission
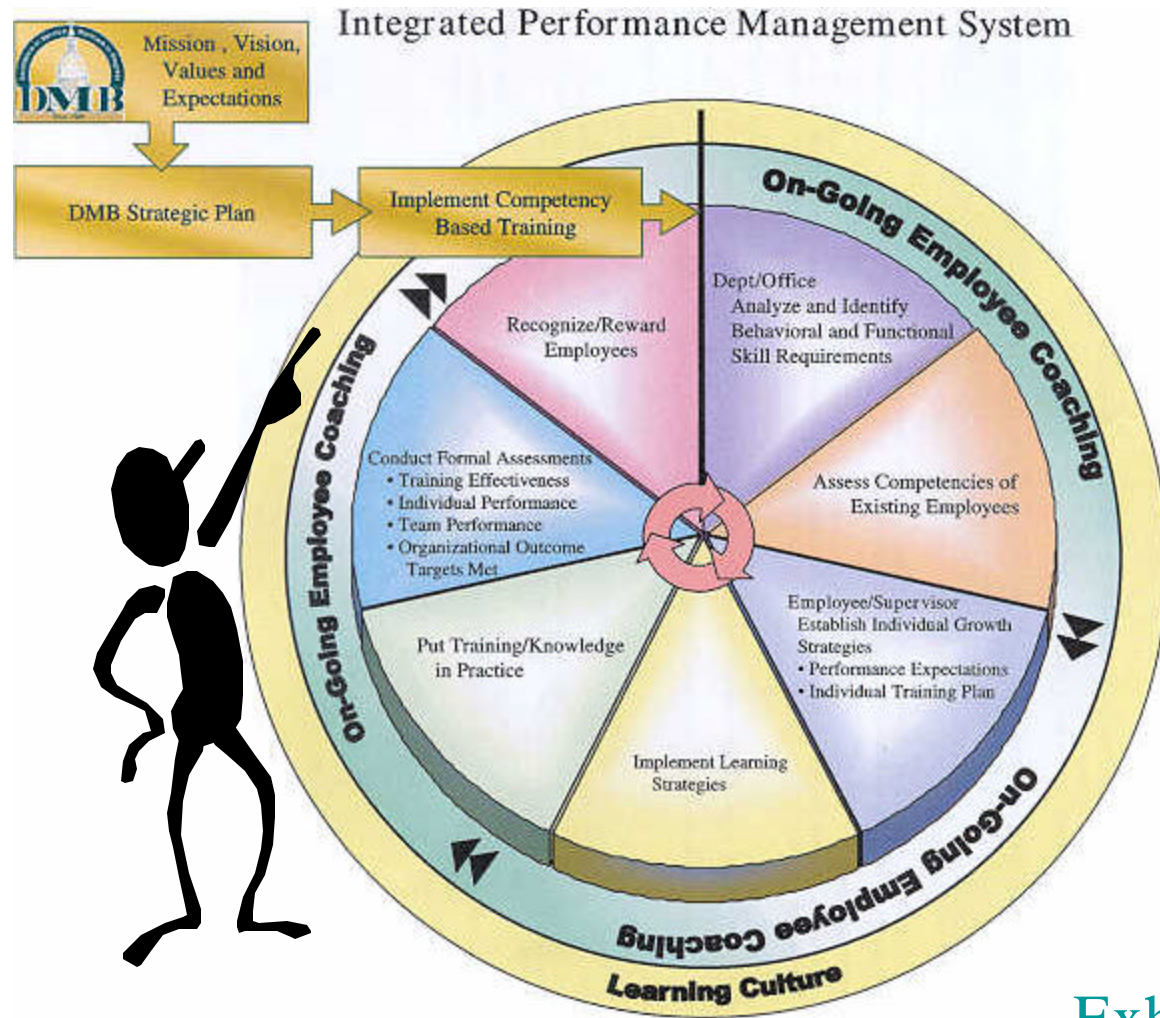
(Regulation 2.06: Rating System)

Behavioral Competencies:

- Individual Job Effectiveness

- Organizational Success

- Working with People

Required Functional Competencies:

- Business Knowledge

- Computer Skills
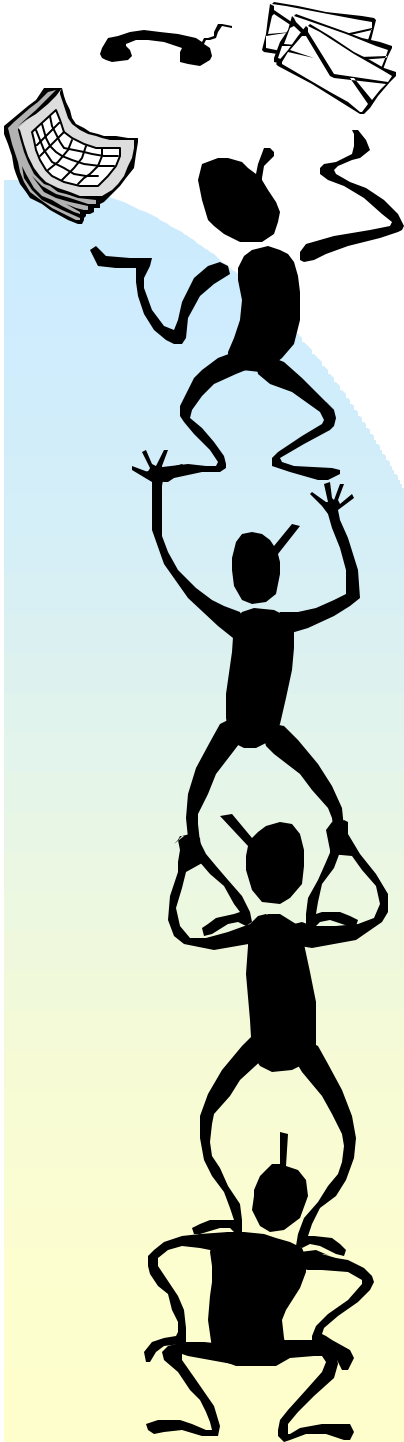
Competency Based Employee Ratings

Integrated Performance Management System

Exh. 3

COMMUNITY HEALTH

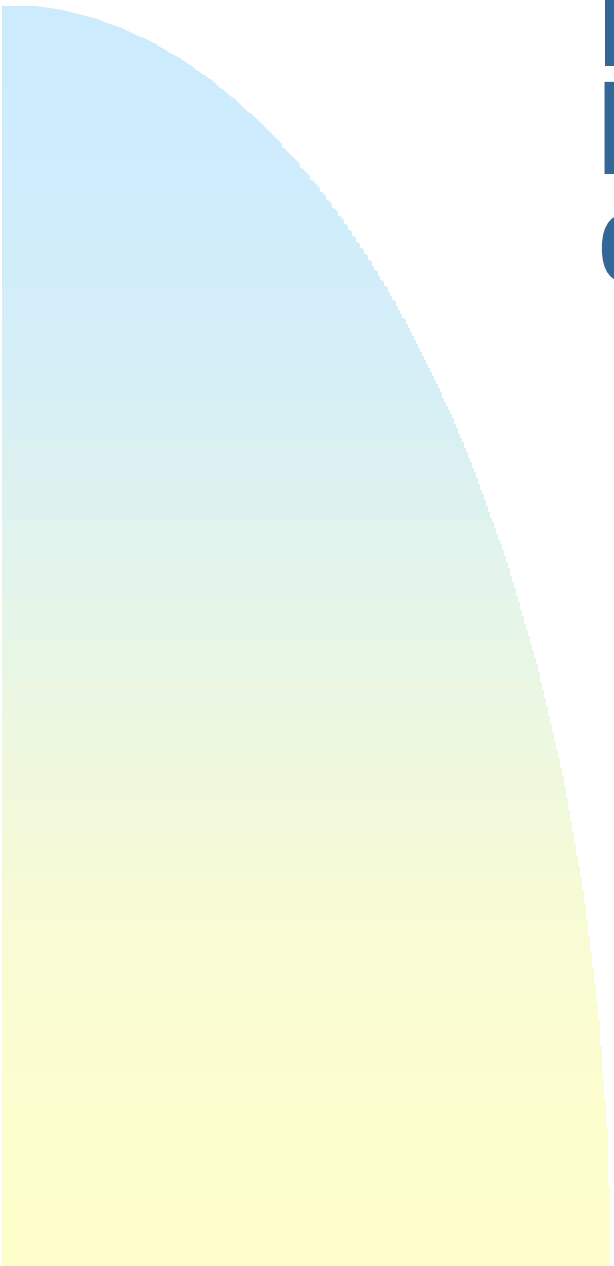## SURVIVOR!

COSO-BASED RISK ASSESSMENT

Karen Spak

Why DCH began using the COSO-Based Risk Assessment Process!

Create a Project Team

- Knowledgeable and experienced staff
  - Teresa Simon
  - Mark Moeller
  - Jodi Kukla
  - Smruti Shah

Identify Large Groupings by Programs or Activities or Operations

- Organization Chart

- Budget

- Staffing

- "Public" Perception

Programs Identified for Review

- Medicaid Program
- Women, Infant, and Children Program
- Community Mental Health Program

Evaluate the Risk Potential of Each Grouping

- How much do you spend?

- What do you control?

- Are contract terms compliant?

- What were previous audit findings and results of other internal analyses?

How Much Do You Spend?

- Appropriation Bill
- Expenditure Reporting
- Inter-Agency Agreements

What Do You Control?

- Direct Vouchers
- Cash Receipts
- Payroll
- Interfaces
- "Other"

Contract Compliance

- Are contracts with sub-recipients compliant with OMB Circular A-87?

- Are contracts with vendors in compliance with the terms and conditions required by DMB Purchasing?

- Are there any new contract programs?

Audit Findings & Internal Reports

- Single Audits

- Performance Audits

- Federal Audits

- Previous Internal Control Reports

- Other Internal Analyses and Reports
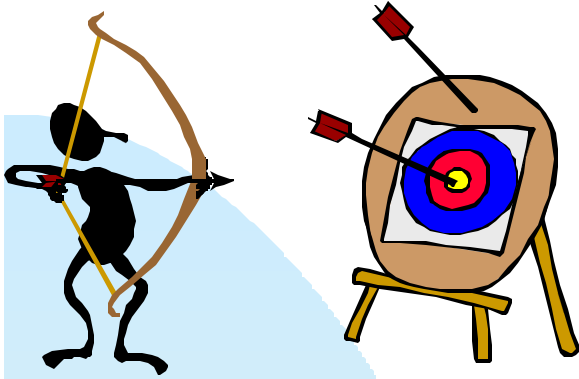
Select Primary "Targets"

- Based on:
  - Funding
  - Risk
  - Logic

Appropriations Selected for Review

	DEPARTMENT OF COMMUNITY HEALTH						
	INTERNAL CONTROL RISK ASSESSMENT						
	APPROPRIATIONS SELECTED FOR REVIEW AND BALANCES AS OF JUNE 30,1999						

Approp Number	Appropriation Description	Appropriation	Expenditures	Payroll	Interface	ADPICS Direct Vouchers	R*STARS Direct Vocuhers	Other Tansactions
02965	Community Mental Health	1,389,995,100.00	1,095,206,852.38	0.00	750,789,829.37	527,118,477.53	0.00	(182,701,454.52)
33550	Health Plan Services	1,170,074,700.00	547,504,696.40	0.00	825,691,691.47	1,108,367.94	5,479,615.00	(284,774,978.01)
33680	Long Term Care Services	942,969,200.00	607,959,289.32	0.00	692,416,627.27	40,574,506.38	0.00	(125,031,844.33)
33860	Special Adjustor Payments	903,971,400.00	856,699,498.00	0.00	0.00	594,462,206.00	0.00	262,237,292.00
33500	Hospital Services and Therapy	618,412,100.00	386,339,869.22	0.00	594,624,331.33	3,669,358.61	0.00	(211,953,820.72)
33540	Pharmaceutical Services	265,754,400.00	207,863,905.18	0.00	198,464,671.47	131,617.54	0.00	9,267,616.17
33520	Physician Services	162,532,900.00	75,339,819.28	0.00	119,850,435.93	79,727.92	0.00	(44,590,344.57)
02991	CMHSP - Purchase of State Services	157,407,400.00	75,030,976.93	0.00	(1,111,320.07)	83,552,817.00	0.00	(7,410,520.00)
14275	WIC Program	151,224,900.00	95,494,617.22	0.00	91,642,899.95	12,633,477.74	158,930.06	(8,940,690.53)
33740	School Based Services	142,782,300.00	43,838,025.80	0.00	0.00	68,488,600.13	0.00	(24,650,574.33)
33780	Adult Home Help Services	138,479,200.00	90,998,770.91	0.00	86,457,521.05	6,540,915.03	0.00	(1,999,665.17)
33590	Medicare Premium Payments	121,372,400.00	87,660,990.89	0.00	(12,239.59)	87,381,474.25	0.00	291,756.23
14355	Medical Care and Treatment	117,433,700.00	51,906,672.46	0.00	54,636,909.65	1,358,372.81	0.00	(4,088,610.00)
	Assessment Total	6,282,409,700.00	4,221,843,983.99	0.00	3,413,451,357.83	1,427,099,918.88	5,638,545.06	(624,345,837.78)
		81.59%	86.02%	0.00%	97.39%	80.69%	11.58%	94.42%
	DCH Total	7,700,087,800.00	4,907,707,227.84	246,821,615.77	3,504,807,136.05	1,768,618,381.58	48,677,979.42	(661,217,884.98)

Exh. 4
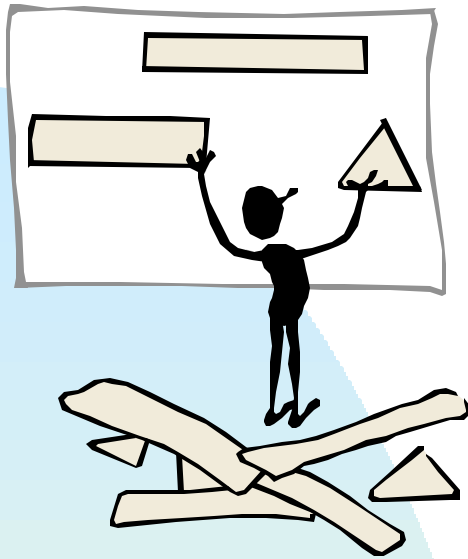
Design a Common Framework

- Draft flow charts
- Identify common components across all targeted areas

Identify "Common" Processes

- Cash Receipting

- Federal Cash Draw

- Direct Disbursements

- Financial Interfaces

- Payroll

- Cost Allocation

Create a Consistent Program Reporting Framework

- Budget and Program Development
- Program Eligibility
- Contract and/or Vendor Selection
- Program Activity
- Financial Effect of Activity
- Financial Reconciliation Analysis and Reporting
- Accruals

Finalize "Targets"

- Re-Evaluate Original Selection
- Expand or Reduce Scope
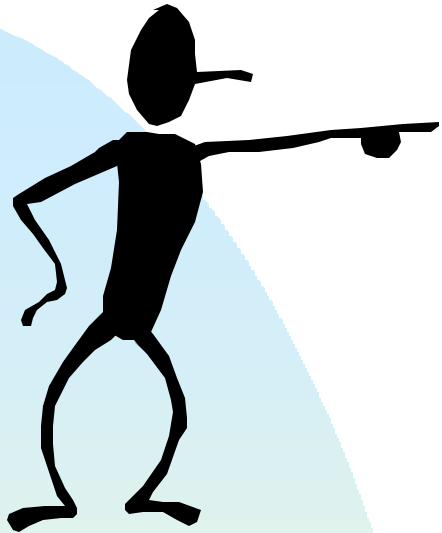- Strive for Quality, Rather than Quantity

"Do" the Detail

- Interactive process combining program knowledge and internal control knowledge

- Some controls may also be risks

- Ask questions

- Have non-involved parties review and comment

Finalize the Flow Charts

- Flow chart steps and processes should match written narrative
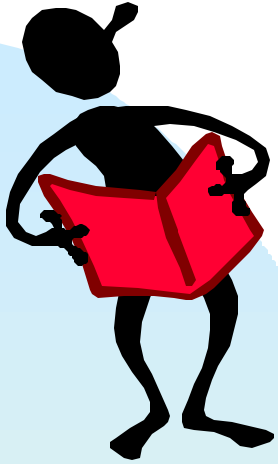
Include Glossary

- Acronyms
- Definitions

Summarize the Document

- Executive Summary
- Summary of Observations
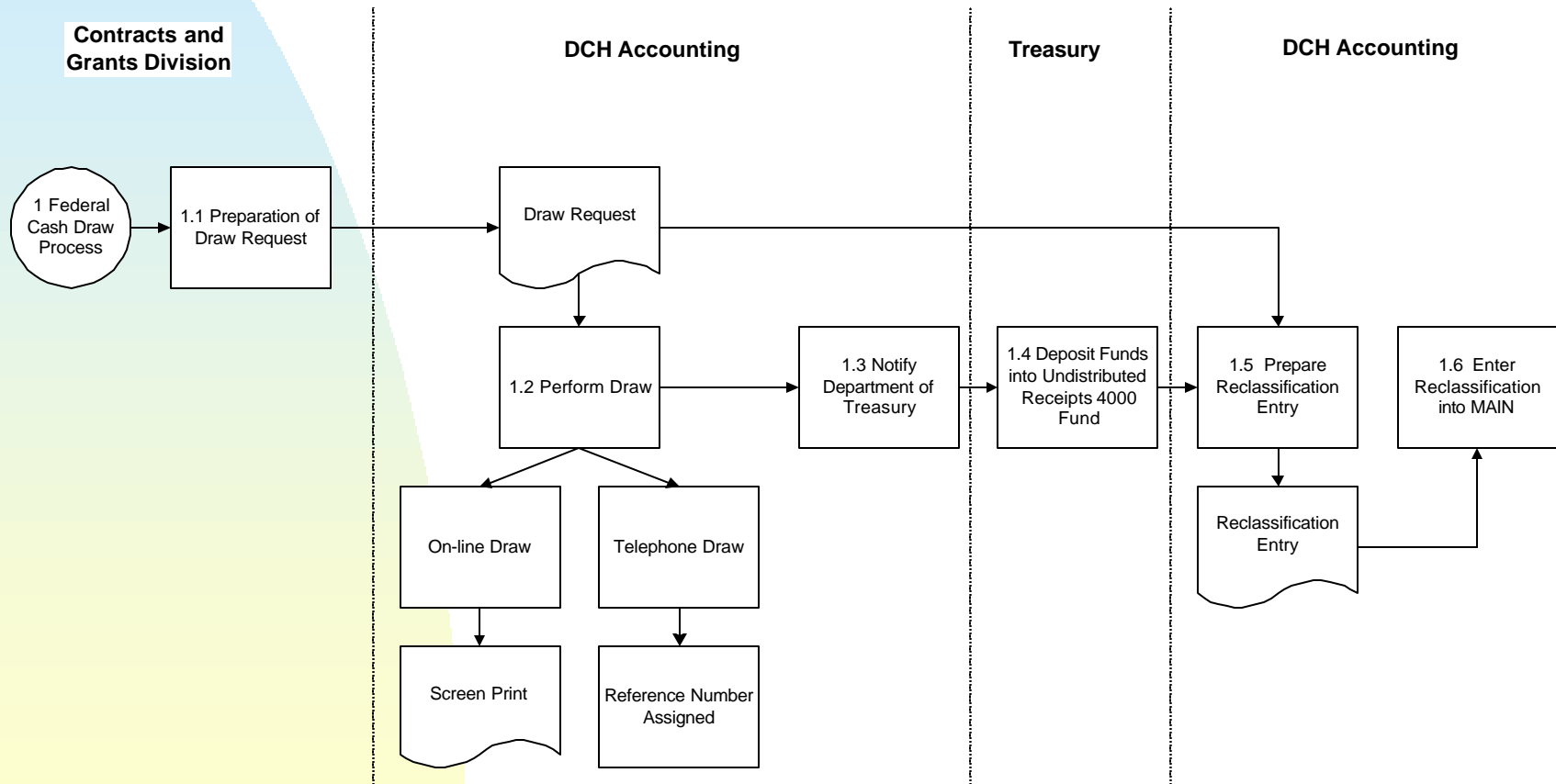 - Positive
  - Negative

Publish the Document

- Continue Updating Process
- Use It for Training

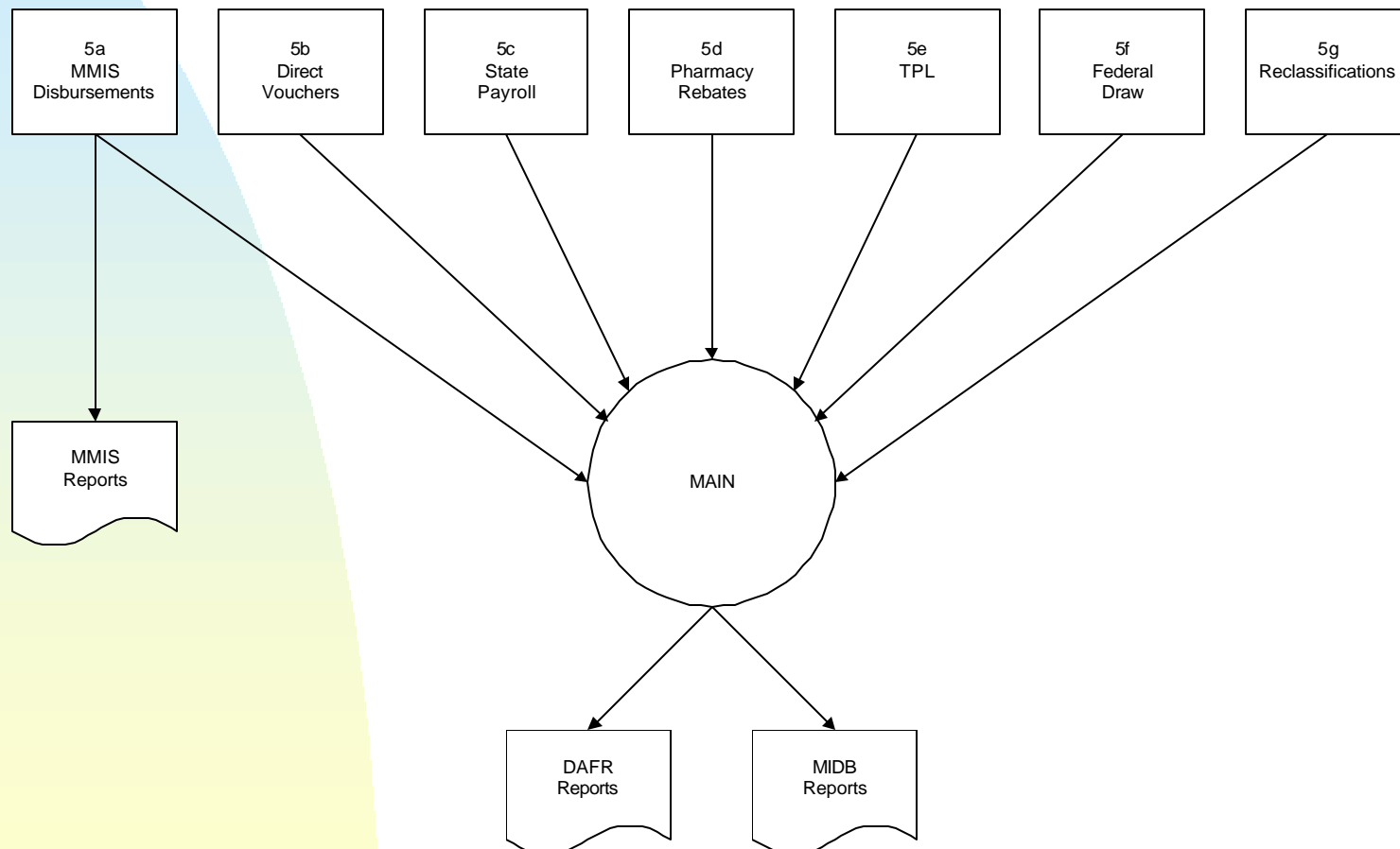# Internal Control Review Should Be A Daily Activity

Federal Cash Draw Process

Exh. 5

Federal Draw Matrix

Narrative	Risks in Process Step	Controls That Address Risks
1.1 Preparation of the Federal Cash Draw Request Contracts and Grants Division accountants prepare federal draw requests based on the specific criteria outlined in each grant. The request includes a reference to the applicable grant, amount of the draw, effective date, and the account number to credit when the draw is received. The Contracts and Grants Division forwards draw request to DCH Accounting for processing.	The draw request may include the incorrect amount, incorrect account coding detail, and/or effective date. Transfer of funds may be delayed due to incorrect or incomplete identification number. The draw may not be performed if the request memo is lost or misplaced. Note: The above risks have an impact on DCH's compliance with the "Cash Management Improvement Act" (CMIA).	Accounting will not process draw requests unless authorized by a Contracts and Grants Supervisor. Accounting reviews draw requests for "reasonableness" in comparison with prior draws performed for that program. The Contracts and Grants Accountant responsible for initiating the draw performs an on-line inquiry in MAIN using the "Grants Transaction Inquiry" 67 screen. The frequency of this review varies by grant. Requests are to be hand delivered to the Accounting employee responsible for the draw. Draws not received would be identified during the reconciliation performed by the Contracts and Grants Division and Budget staff.
1.2 Performance of the Federal Cash Draw Upon receiving the draw request memo, the designated draw employee within the DCH Accounting Revenue Unit updates a separate summary sheet for each program, recording the date and amount of the draw. The actual draw process is performed using one of the following processes, as dictated by the granting federal agency. Each process has at least one password requirement.	The improper program summary sheet may be referenced and updated. Draws may not be performed or completed in a timely manner due to multiple draw processes and processing time required.	Secondary employees have been assigned to assist the employee responsible for the draw.

Exh. 6

Medicaid Financial Activity Process

5a MMIS Disbursements	5b Direct Vouchers	5c State Payroll	5d Pharmacy Rebates	5e TPL	5f Federal Draw	5g Reclassifications

MMIS Reports

MAIN

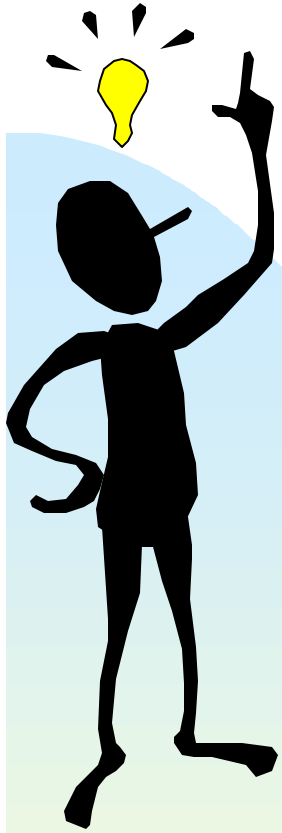DAFR Reports

MIDB Reports

Exh. 7

State Police

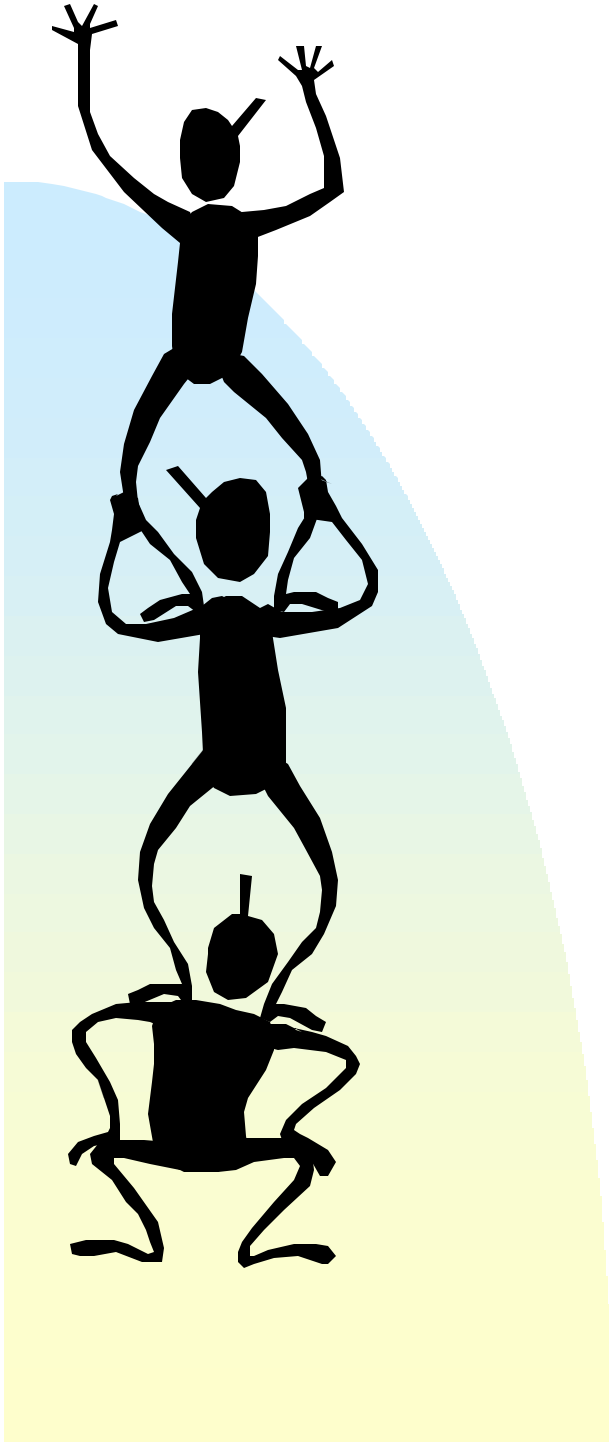## SURVIVOR!
COSO-BASED ICS EVALUATION
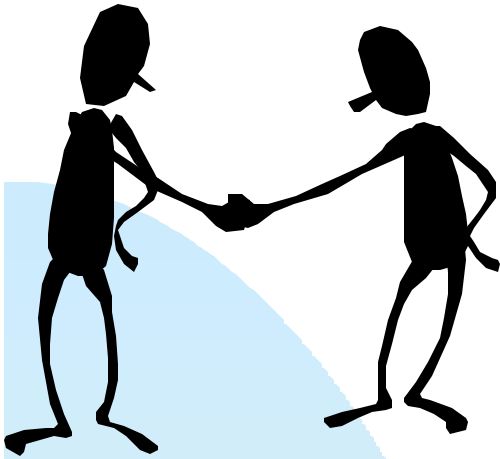
Mike Kelterborn

Sherri Forbes

Topics of Discussion

- Implementation Strategy at State Police
- Current Challenges
- How COSO can help
- Vision for the Future

Strategy at State Police

- Control Environment and Information & Communication "Soft Controls"

- Financial Processes

- Non-financial Processes
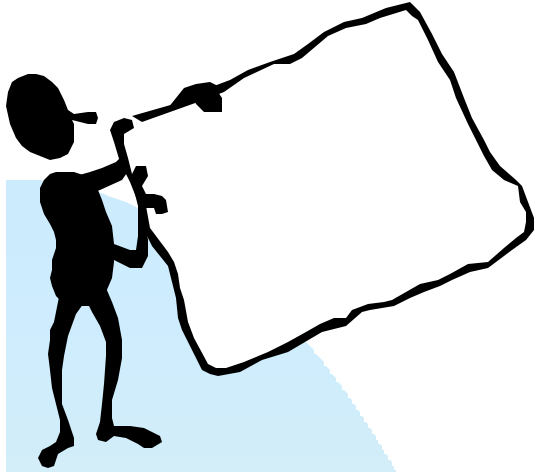
- Information Technology

Control Environment and Information & Communication

- Partner with Office of Organizational Development
- Need to reach the worker bees
- Survey Instruments
- Pre-existing surveys

Financial Processes

- Chief Accountant leadership
- Transaction Cycles
- Stakeholders Recruited
- Focus Groups

Non-financial Processes

- Briefings at Staff meetings
- Work up of Sample
- Letter from Director
- Identify related processes

ICS Evaluation

State of Michigan
Evaluation of the Internal Control Structure (ICS)
In Effect During the Two-year Period Ended September 30, 2000

- Worksheet for Evaluating the *Risks, Control Activities, and the Monitoring* Components of the ICS -

Note: Instructions for this worksheet are not included on this page. For specific instructions for completing this worksheet, click here.

Description of Departmental Activity: __Forensic Laboratory Analysis _____

FOR EXAMPLE PURPOSES ONLY

Activity Level Objective	Risk Factors Associated with the Activity Level Objective	Actions/Control Activities Intended to Address Risk Factors	Monitoring (e.g., tests of controls, etc.)	Conclusion (Sufficiency/Effectiveness of Existing Internal Controls) and Corrective Action
1. Casework files are receipted and reports are prepared timely.	Cases may go to trial without adequate evidence to prosecute or exonerate the defendant if cases are not receipted and worked in a timely manner.	Review case completion monthly. Catalog complaints from law enforcement agencies and prosecuting attorney offices regarding casework that is not completed before they need it for court.	Annually select a sample of completed case reports and review them for timeliness. Periodically, send out a survey to users (law enforcement agencies, judges, and prosecuting attorneys) requesting feedback.	Casework was being receipted and completed in a timely manner.
2. Lab scientists are competent in the areas in which they conduct casework.	Lab scientists may not have adequate training in the areas of work being performed, which may result in inaccurate and incomplete conclusions.	Annual evaluations require lab scientists to perform blind tests to provide insight as to areas needing additional training or indications of proper knowledge and processing.	Review the blind tests performed by the lab scientists for proper calculations and conclusions. Ensure that follow-up such as training or counseling has been conducted for those who did not score appropriately	Lab scientists were completing blind tests and follow-up was performed when necessary
3. Cases are accurate and complete (Peer and/or Administrative Review).	Reports may be misleading.	Require administrative and/or peer review of completed casework to provide additional assurance as to the accuracy and completeness of the report issued.	Select a sample of completed cases to determine if they have had administrative and/or peer review.	Final reports were administratively or peer reviewed for accuracy and completeness before being released.
4. Lab instruments operate accurately.	Lab scientists may obtain inaccurate data/results from samples tested, resulting in an inconclusive or incorrect report being issued if lab instruments and equipment are not regularly calibrated and maintained.	Require that lab instruments be calibrated at least weekly. Also require that proper maintenance be performed on equipment and instruments as specified by the manufacturer.	Select a sample of instruments from each lab and review the calibration and maintenance logs to ensure the procedures have been followed.	Lab instruments and equipment were NOT calibrated and maintained in accordance with industry and/or manufacturer recommendations. For corrective action, the labs are required to send documentation of calibration and maintenance of instruments and equipment to division headquarters weekly.

Exh. 8

Information Technology

- High Risk Area

- Chief Information Officer leadership

- COBIT (Control Objectives for Information Technology)

- Contract for Assistance

Current Challenge - Overcoming Management Apathy

- Past evaluation tools and process were limited

- Little follow up and remedial action

- Pay for Performance

- Training

- Honey vs. Hammer

How COSO can help

- Internal Control documentation is relevant to our world

- COSO emphasizes a broad scope evaluation of program objective related activities

- COSO emphasizes a participatory process

- Process viewed as a ongoing event with experience building on each cycle

- Relevant results and success stories will drive follow up and remedial action
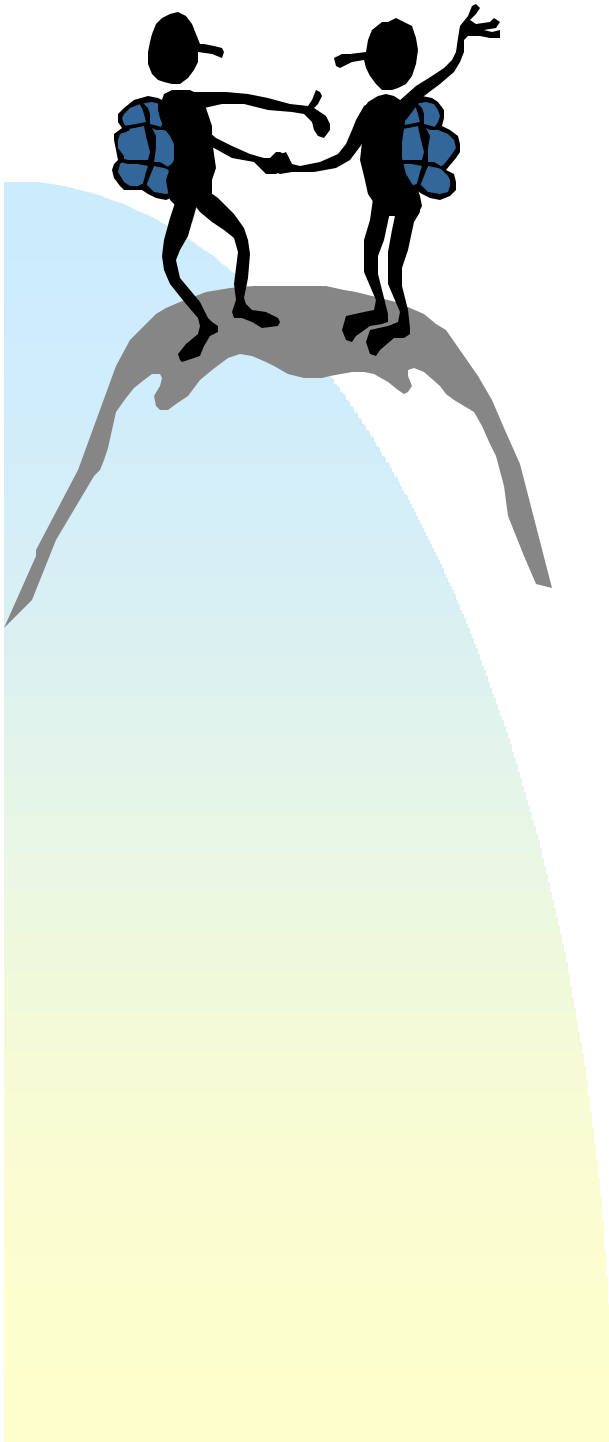
Vision for the Future

- Transform Internal Control Evaluation to a value added process

- The Internal Control System and ICE is owned by, rather than imposed on management

- Full benefits of ICE are realized and results become basis for the audit plan

- Internal Control is Strengthened